Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
GTE CORPORATION,	)	
	)	
Transferor,	)	
	)	
and	)	CC Docket No. 98-184
	)	
BELL ATLANTIC CORPORATION,	)	
	)	
Transferee,	)	
	)	
For Consent to Transfer of Control	)	

RESPONSE OF BELL ATLANTIC AND GTE IN SUPPORT OF PROPOSAL TO TRANSFER GTE INTERNETWORKING TO A SEPARATE CORPORATION OWNED AND CONTROLLED BY PUBLIC SHAREHOLDERS

Mark J. Mathis
John Thorne
Michael E. Glover
Leslie A. Vial
Lawrence W. Katz
BELL ATLANTIC CORPORATION
1095 Avenue of the Americas
New York, New York 10036

Richard E. Wiley
R. Michael Senkowski
Suzanne Yelen
WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, D.C. 20006

William P. Barr
GTE CORPORATION
1850 M Street, N.W.
Suite 1200
Washington, D.C. 20036

Steven G. Bradbury
John P. Frantz
Kelion N. Kasler
M. Todd Henderson
KIRKLAND & ELLIS
655 Fifteenth Street, N.W.
Suite 1200
Washington, D.C. 20005

Counsel for Applicants Bell Atlantic Corporation and GTE Corporation

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Pursuant to the Commission's Public Notice of January 31, 2000, Bell Atlantic and GTE respectfully submit this Response to comments opposing their proposal to transfer GTE Internetworking ("GTE-I") to an independent corporation ("DataCo") that will be 90% owned and controlled by public shareholders pending interLATA relief.

INTRODUCTION AND SUMMARY

The only significant opposition to our DataCo proposal comes from AT&T and its allies at CompTel.[1] As one of the three leading Internet backbone operators and the biggest interexchange carrier, AT&T has a clear incentive to oppose any proposal, like the DataCo solution, that promises to preserve GTE-I as a strong, independent competitor on the Internet that is unaffiliated with any large IXC. Undoubtedly, AT&T would welcome an opportunity to increase its own backbone position even further by acquiring GTE-I itself should Bell Atlantic/GTE be prohibited from holding the proposed option to take back DataCo.

AT&T, however, has offered no authority or argument that undermines our fundamental proposition – that a right to take a potential future equity interest, like an option or other conversion right, is not a current equity interest that counts against the ownership cap in section 3(1)'s definition of "affiliate." AT&T's attack is long on artful rhetoric but lacking in true substance; it is based on a twisted reading of section 3(1), a dishonest use of Commission precedents, and an overdose of hyperbole that ignores settled concepts of corporate law. Both AT&T and CompTel take aim at the investor safeguards detailed in Schedule A of our Supplemental Filing and expend most of their ammunition on the issue of control. But no opponent denies that these safeguards are common in executory purchase contracts or that the Commission has repeatedly held in analogous contexts that all of the basic safeguards proposed here, *taken together*, do not constitute *de facto* control. AT&T's challenge to our investor safeguards is particularly hypocritical because it is directly contradicted by

[1] Opposition of AT&T Corp. to Applicants' Proposal Regarding GTE's InterLATA Operations (Feb. 15, 2000) (hereinafter "AT&T Opp."); Comments of the Competitive Telecommunications Association (Feb. 15, 2000) (hereinafter "CompTel"). Other opponents, including Covad, ALTS, NextWave and the Telecommunications Resellers Associations, filed comments that are more rhetorical than substantive. The Communications Workers of America and the Progress and Freedom Foundation filed comments supporting the DataCo proposal.

AT&T's own arguments in support of its acquisition of MediaOne and the very similar safeguards it enjoys there. Finally, AT&T's breathless claims that the DataCo structure is somehow contrary to the purposes of section 271 are (to put it charitably) insubstantial.

Notwithstanding AT&T's bluster, the DataCo solution proposed in our Supplemental Filing is fully consistent with the requirements of sections 3(1) and 271 and is amply supported by basic corporate law principles and analogous Commission and MFJ precedents. The Commission will be on solid legal ground in affirming that the merger of Bell Atlantic and GTE, with the conditions we have proposed and the DataCo interLATA solution we intend to implement, is manifestly in the public interest.[2]

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[2] Our proposed DataCo solution will eliminate all section 271 issues arising from the operations of GTE-I. The assets transferred to DataCo will include all of GTE's Internet backbone and related data businesses, including the nationwide Global Network Infrastructure, or "GNI," the BBN Planet backbone and related backbone operations, GTE-I's Internet connectivity services for business customers and national modem and frame relay networks, its Web hosting and Internet security services, and various other interLATA data transport services and network operations. Certain non-

ARGUMENT

I. BEFORE EXERCISING ITS CONVERSION RIGHTS, BELL ATLANTIC/GTE WILL NOT OWN AN EQUITY INTEREST IN DATACO OF MORE THAN 10%.

The text of the Act, basic corporate law principles, relevant Commission precedent, and the MFJ line of cases cited in our Supplemental Filing all establish that, until it exercises its conversion rights, Bell Atlantic/GTE will own no more than the permitted 10% equity interest in DataCo. AT&T is the only opponent who tries to argue at length that our conversion rights ought to count as current equity interests for purposes of the "affiliate" definition in section 3(1). But in all the rhetoric AT&T offers, one glaring truth shines through: *AT&T has cited no case law or other authority to call into question the general rule that options and other conversion rights are not current equity interests.*

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interLATA operations currently organized within GTE-I, including GTE.net's dial-up ISP service and the research and development operations of BBN Technologies, will not be transferred to DataCo. GTE will cease providing all other non-GTE-I voice and data interLATA services within Bell Atlantic's non-271-approved states before consummating the merger with Bell Atlantic. With respect to traditional resold voice long distance service provided to residential customers, for example, GTE will notify its customers by letter on February 24, 2000, that they may select another long distance provider (and will provide a coupon to defray the costs of switch over); any customers who do not select another provider by March 20 will receive Sprint long distance service by default, subject to the Commission's approval of Sprint's petition for waiver of the customer authorization and verification rules. *See* Sprint's Petition for Waiver, *In re Implementation of the Subscriber Changes Provisions of the Telecommunications Act of 1996, Policies and Rules Concerning Unauthorized Changes of Consumers' Long Distance Carriers*, CC Docket No. 94-129 (filed Feb. 16, 2000).

A. Section 3(1) and Controlling Principles of Corporate Law.

Under our proposal, DataCo's Class A public shareholders will hold 90% of the equity interest in DataCo until the Class B conversion rights are exercised. As we explained in our Supplemental Filing, options and convertible securities, like the conversion rights Bell Atlantic/GTE will hold, lack all three of the traditional participation rights of equity stock and therefore do not constitute equity interests. They represent merely the right to take a future equity interest upon conversion. *See* Declaration of Professor Ronald J. Gilson ¶¶ 15-22.[3] (Professor Ronald J. Gilson, whose declaration in support of this response is appended hereto at tab A, is the Charles J. Meyers Professor of Law and Business at Stanford Law School and the Marc and Eva Stern Professor of Law and Business at the Columbia University School of Law. Professor Gilson is also a principal author of the American Law Institute's Principles of Corporate Governance, as well as co-author of *The Law and Finance of Corporate Acquisitions* (1995), the leading text on the law and economics of acquisition transactions. *See* Gilson Declaration ¶¶ 1-5.)

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[3] The ownership of an equity interest in a corporation is represented by stock, and the equity characteristics of stock include: (1) a right to a share of voting control over a corporation's management, (2) a right to participate in residual earnings through a distribution of dividends, and (3) a right, upon dissolution, to share in residual proceeds from liquidation of the assets. Gilson Declaration ¶ 15; 11 Fletcher's Cyclopedia of the Law of Private Corporations § 5081 (perm. rev. ed. 1995); *Paulsen v. Commissioner*, 469 U.S. 131, 138 (1985); *United States v. Evans*, 375 F.2d 730, 731 (9th Cir. 1967).

Consistent with the plain language of section 3(1), which is written in the present tense ("owns," "is owned," "is under common ownership"), only *current* equity interests count for "affiliate" purposes. Accordingly, the *future* interests represented by the proposed conversion rights will not give Bell Atlantic/GTE an ownership interest in DataCo of greater than 10% until they are exercised. This conclusion is supported by established rules of property and corporate law and by all the Commission attribution rulings and MFJ precedents cited in our Supplemental Filing. *See* Supp. Filing at 34-44.

AT&T argues, however, that "[f]uture interests such as the conversion rights at issue here . . . must be taken into account in determining whether Bell Atlantic 'owns' DataCo both because they constitute '*indirect*' ownership and because they can be '*equivalent*' to equity ownership" for purposes of section 3(1). AT&T Opp. at 12 (emphasis added). This reading of the affiliate provision is incorrect. By reaching affiliates that are "indirectly" owned, section 3(1) is plainly referring to situations where one entity owns another through an intermediary entity, such as a holding company or other affiliate. Here, Bell Atlantic/GTE will not own any additional equity in DataCo through intermediaries. Nor are the proposed conversion rights the "equivalent" of an equity interest. As Bell Atlantic/GTE explained in its Supplemental Filing, the phrase "(or the equivalent thereof)" in section 3(1) must be read to refer to ownership interests, such as a partnership interest, non-voting stock, or an interest nominally styled as debt, that, while not carrying the voting rights or usual form of common stock, still carries the other traditional economic rights of equity ownership, including the right to receive a share of current profits. *See* Gilson Declaration ¶ 18; Supp. Filing at 35 n.21.[4]

[4] *See also In re Application of Fox Television Stations, Inc.*, 11 FCC Rcd 5714, ¶¶ 14-18, 20 (1995) (foreign entity held to own more than 25% of capital stock of domestic broadcast licensee

Without one or more of the traditional attributes of equity ownership, an interest simply cannot constitute the "equivalent" of equity. Gilson Declaration ¶ 18.

AT&T tries to confuse the issue of equity ownership by asserting that it is unlikely that DataCo will pay dividends in the near future. *See* AT&T Opp. at 9-10. But it is irrelevant whether or not DataCo is likely to issue dividends in the next five years; what is controlling is that DataCo's public shareholders will hold 90% of the *rights to dividends*. AT&T is also wrong when it suggests that Bell Atlantic/GTE will be able to prevent the payment of dividends to public shareholders through the manipulation of its investor safeguards. *See id.* at 10. The investor safeguards will require approval only for *extraordinary* dividends – that is, those that are not paid out of earned surplus. *See* Supp. Filing, Schedule A. (AT&T should know as much, since it enjoys the *very same* investor safeguard against "extraordinary" dividends in its merger agreement with MediaOne. *See*

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because, although a domestic citizen owned 76% of voting shares, foreign entity was entitled to receive 99% of current profits and assets upon sale or dissolution). In addition, *In re Applications of Nextwave Personal Communications, Inc.*, 12 FCC Rcd 2030 (1997), also cited by AT&T, affirmatively supports the principle that an option to acquire an equity interest in the future is not the equivalent of a present equity interest. There, the Commission stated that "future interests including warrants, options, and convertible debt do not constitute capital stock until exercised or converted." *Id.* ¶ 46. *See also* Supp. Filing at 38-39 (citing additional cases). Thus, AT&T's claim that this rule is trumped if the ownership of corporate shares does not correspond to capital contributions finds no support with regard to unexercised options. *Compare Nextwave Personal Communications*, 12 FCC Rcd 2030, ¶ 46, *with* AT&T Opp. at 16.

Gilson Declaration ¶ 26.) If DataCo, as is common for a growth company on the Internet, chooses to reinvest earnings in its business and not to issue dividends, the public shareholders who own 90% of DataCo will not see their equity diminished. The millions of investors who own stock in such growth companies do not hold any less equity simply because they receive no dividends.

Similarly, AT&T claims that Bell Atlantic/GTE will own 80% of DataCo before exercising its conversion rights because "it is a certainty" that Bell Atlantic/GTE will eventually exercise those rights and take back control of DataCo within the five-year period. *See* AT&T Opp. at 7-9. AT&T is wrong. There is a genuine possibility that Bell Atlantic/GTE will not exercise its conversion rights. Bell Atlantic/GTE's exercise of the option will be directly contingent on its ability to secure sufficient interLATA relief to operate the DataCo business within five years – a truly formidable obstacle, given the fact that only *one* 271 approval has been granted in the past four years. Accordingly, there is a genuine and substantial possibility that Bell Atlantic/GTE will lose the opportunity to take back DataCo and will have to forfeit its interest in the business by selling its Class B stock to another potential acquirer.[5] Furthermore, even if it were a near certainty that Bell Atlantic/GTE would exercise its rights and assume control of DataCo, that would still not transform the option into current equity. All options or other conversion rights are always contingent on their exercise, even if they can be exercised at no additional cost.[6] Until he chooses to exercise, the holder of such rights still owns nothing more than an *option* to take an equity interest *in the future*.[7]

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[5] Bell Atlantic/GTE intends to exercise its option once it has secured sufficient interLATA relief to operate the DataCo business. If, for example, Bell Atlantic/GTE has successfully obtained 271 approval in all of the major Bell Atlantic states but still lacks interLATA authority in one or more of the smaller states, Bell Atlantic/GTE may decide to exercise the option and cause DataCo to cease providing interLATA services in the non-271-approved states.

[6] *See In re Richard R. Zaragoza*, 14 FCC Rcd 1732, ¶ 20 (1998) ("purchase options and other

potential future rights are noncognizable for current attribution purposes," and the Commission will not "presum[e] that an option will be exercised," even where the purchase price for the option is paid "*up front*." (emphasis added)). See *also* Supp. Filing at 39.

[7] *See Biennial Review of Spectrum Aggregation Limits*, Report and Order, WT Docket No. 98-205, ¶ 8 (Sept. 22, 1999) (options, warrants, and other convertible securities are nothing more than "potential future equity interests"); *In re Woods Communications Group*, 12 FCC Rcd 14042, ¶¶ 13-14 (1997) (characterizing options as "future equity holdings" and "possible equity interests").

It is equally wrong to suggest that Bell Atlantic/GTE will own more than 10% of DataCo within the meaning of section 3(1) merely because the IPO of DataCo's publicly held shares will not raise cash equal to 90% of the total value of the DataCo enterprise. AT&T Opp. at 7. The amount raised in the IPO will reflect the potential that Bell Atlantic/GTE will exercise its conversion rights in the next five years and, thus, the potential that the public shareholder's 90% equity interest in DataCo will step down toward 20%. Investors will likely value the stock somewhere above 20% of DataCo's value as a business, given that the public shareholders will have the right to 90% of any distributions that occur before the conversion rights are exercised. If the IPO valuation is close to 20% of the overall value of DataCo, that will reflect a belief by investors that Bell Atlantic will open its local markets and receive interLATA relief well before expiration of the five year term.

Moreover, the trading price of the Class A shares on the public markets will naturally reflect the fact that the Class B conversion rights have significant value, but that does not reduce the equity interest represented by the Class A stock. *See* Gilson Declaration ¶ 16 n.3. It is common for fixed-price options, warrants or other such conversion rights to affect the valuation of publicly traded stock before they are exercised. Where, for example, a company has outstanding publicly traded warrants that are "in the money" – *i.e.*, warrants that have an exercise price below the value of the underlying stock – they impact the market value of the outstanding stock, because the market takes into account the likely future dilution that will occur when the warrants are exercised. Although the reduction in market price reflects the value of the warrants, the warrant holders are accorded none of the rights of equity ownership prior to exercise, and thus have no equity interest. *Id.*

B. Commission Precedents.

The key point on equity ownership is the general background rule of law that options and other conversion rights confer no ownership until they are exercised.[8] All of the Commission's attribution rules and other precedents that we cited in our Supplemental Filing represent specific applications of this general rule. AT&T never contests the general legal principle that supports our arguments on equity ownership. AT&T simply picks at several of the Commission precedents we relied on in our Supplemental Filing. It is, however, not enough for our opponents to distinguish one or more of the particular applications of the general rule *without calling the rule itself into question*. In any event, even as AT&T attempts to distinguish individual Commission precedents, it engages in a systematic misrepresentation of those precedents.

First, the Cable Bureau's decision in *In re Time Warner Cable*, 12 FCC Rcd 23363 (1997), is on all fours with the principle that an option does not count as an "equity interest (or the equivalent

[8] *See* Gilson Declaration ¶ 16. *See, e.g., Nerken v. Standard Oil Co.*, 810 F.2d 1230, 1232 (D.C. Cir. 1987) ("[O]ne is not an owner of common stock prior to conversion of the preferred or before an option to buy has been exercised."); *Martin v. Schindley*, 442 S.E.2d 239, 241 (Ga. 1994) ("An option to purchase land does not, before acceptance, vest in the holder of the option any interest, legal or equitable, in the land."); *Webb v. R.O.A. General, Inc.*, 773 P.2d 834, 838-39 (Utah Ct. App. 1989) (option holder has no legal title to shares until exchange of shares actually takes place after exercise of option); *Ball v. Overton Square, Inc.*, 731 S.W.2d 536, 540 (Tenn Ct. App. 1987) ("[A]n option to purchase stock does not vest in the prospective purchaser an equitable title to, or any interest or right, in the stock."); *Thatcher v. Weston*, 83 N.E. 360, 361 (Mass. 1908) (holder of option to purchase real estate has no ownership interest in the property).

thereof)" under section 3(1). *See* Supp. Filing at 36-37. There, Bell Atlantic owned "7,000 shares of CAI Senior Preferred Stock, which [were] unilaterally convertible into shares of CAI Voting Preferred Stock, which [were] then unilaterally convertible into shares of CAI Common Stock." *Time Warner* ¶ 4. Despite the fact that Bell Atlantic had the right to convert its preferred shares into voting shares at will, and that, if converted, Bell Atlantic would have greater than a 10% ownership interest in CAI, *see id.* ¶ 5, the Cable Bureau found that the "Bell Atlantic and NYNEX interest in CAI should not be viewed here as an equity or equivalent interest" for purposes of section 3(1). *Id.* ¶ 19 (analysis section). AT&T goes through futile contortions to distinguish *Time Warner*. It falsely asserts that the Cable Bureau was not construing section 3(1), but only section 623. AT&T Opp. at 14. While section 623 was also implicated, *Time Warner* turned on the application and analysis of section 3(1). *See Time Warner Cable* ¶¶ 15, 17. In the Cable Bureau's own words: "The issue here is whether separately or in combination, these interests involve '*an equity interest (or the equivalent thereof) of more than 10 percent*.'" *Id.* ¶ 17 (emphasis added) (quoting *Cable Act Reform Order*, 11 FCC Rcd 5937, 5944 (1996) (quoting Section 3(1))). The bottom line is that the preferred stock in *Time Warner* – which was convertible into voting shares at will – did not count as "equity (or the equivalent thereof)" under section 3(1).

AT&T also tries to escape the implications of *Time Warner* by relying on the Commission's *Cable Attribution Order*. *See In re Implementation of 1992 Cable Act*, CS Docket No. 98-82 (1999) ("*Cable Attribution Order*"). That order, however, does not apply section 3(1) and says nothing about whether an option or other conversion rights may qualify as an "equity interest (or the equivalent thereof)." Thus, it certainly did not supersede the Cable Bureau's interpretation of section 3(1), as AT&T suggests. *See* AT&T Opp. at 15 n.9. In fact, the Commission expressly stated in the

Cable Attribution Order that it was not interpreting section 3(1): "Given that we have not adopted the Title I definition of affiliate, we need not determine what constitutes an interest 'equivalent' to an equity interest." *Cable Attribution Order* ¶ 129.

AT&T hangs its hat on the *Cable Attribution Order*'s 33% "equity plus debt" rule. Far from supporting AT&T, that rule actually proves our case. Under the "equity plus debt" rule, the Commission will attribute a cable system to a party that holds equity and debt interests in the system that, taken together, exceed 33% of the total value of the system's assets. *See* 47 CFR § 76.501, Note 2(i). AT&T flatly misrepresents that rule by asserting that options are counted as equity in calculating the 33% "equity plus debt" threshold. AT&T Opp. at 13. The rule itself refutes that assertion and confirms that options and other such conversion rights are *not* counted as either equity or debt. In its *Cable Attribution Order*, the Commission stated that "[w]e . . . define equity to include all stock, whether common or preferred and whether voting or nonvoting, and all partnership interests" – in other words, *not* to include options and other conversion rights. *Cable Attribution Order* ¶ 82. Consistent with that definition, the cable attribution rules make it clear that "options or other non-voting interests with rights of conversion to voting interests shall not be attributed unless and until conversion is effected." 47 CFR § 76.501, Note 2(e). The "equity plus debt" attribution rule requires only the attribution of "equity (including all stockholdings, whether voting or nonvoting, common or preferred, and partnership interests) and debt interest or interests" that "exceed 33 percent of the total asset value . . . of that entity." 47 CFR § 76.501, Note 2(i). Accordingly, while debt and non-voting stock are attributable under Note 2(i), the other interests listed in Note 2(e) – namely, "options" – are *not* counted against the 33% threshold "unless and until conversion is effected." 47 C.F.R. § 76.501, Note 2(e).

AT&T similarly misrepresents the broadcast attribution rules. It states (wrongly) that the *Broadcast Attribution Order* "'review[ed]' and 'amend[ed]'" the attribution rules cited in our Supplemental Filing. AT&T Opp. at 15. In fact, AT&T can point to not a single word in the *Broadcast Attribution Order* that amends (or even arguably conflicts with) the *twice-stated* rule that "nonvoting instruments such as options" are not attributable. *See Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*, MM Docket No. 94-150, ¶ 2 n.4 (1999) ("The following corporate interests are not currently attributable: minority stockholdings in corporations with a single majority shareholder; nonvoting stock; other nonvoting instruments such as options or warrants; and debt."); *id.* ¶ 26 n.66 ("Also nonattributable are nonvoting stock, other nonvoting instruments such as options or warrants, and debt.") (citing 47 C.F.R. § 73.3555, Note 2(b) & (f)). *See also In re Applications of Quincy D. Jones*, 11 FCC Rcd. 2481, ¶ 29 (1995) ("unexercised future interests . . . are not cognizable under our attribution rules for corporations"). Like much of its Opposition, AT&T's reading of the broadcast attribution rules is supported by nothing but wishful thinking.[9]

[9] AT&T does not even try to mischaracterize the CMRS and LEC/LMDS attribution rules that we cited in our Supplemental Filing. Instead, it simply asserts that these rules are "irrelevant to construing Section 3(1)." AT&T Opp. at 16. But they are just as analogous as any of the other attribution rules that we discuss. And just like the broadcasting and cable attribution rules, the CMRS and LEC/LMDS rules squarely hold that future interests like options are not attributable until exercised. *See* Supp. Filing at 37-38.

C. MFJ Precedents.

Finally, AT&T cannot avoid the direct precedential value of the long line of MFJ cases discussed in our Supplemental Filing. Those cases demonstrate that the Justice Department repeatedly approved and Judge Greene repeatedly allowed options to be acquired by BOCs in prohibited businesses, including interLATA businesses. These included pre-paid options that could be exercised for no additional trigger price, as well as fixed-price options that could later be sold to third parties for full (or even increased) value if the BOC was ultimately unsuccessful in obtaining the MFJ waiver necessary to exercise the option. *See* Supp. Filing at 40-43.

AT&T claims that our DataCo proposal does not comport with the three factors Judge Greene applied in approving conditional interests. AT&T Opp. at 19.[10] No authority requires the Commission to apply the same factors Judge Greene developed under the MFJ when considering whether options or other conversion rights acquired by BOCs are consistent with sections 3(1) and 271 of the Act. Nevertheless, the DataCo structure clearly would have satisfied Judge Greene's standards. First, the relative size of GTE's investment in the GTE-I assets to be transferred to DataCo is minor (about $1.3 billion) compared to Bell Atlantic/GTE's overall revenues (over $57 billion). *Cf.* Conditional Interest Order at 6 (comparing size of NYNEX's investment in Tel-Optik with NYNEX's overall revenues). Second, as discussed above, there is a genuine contingency to whether Bell Atlantic/GTE will receive the necessary interLATA relief to be able to exercise its conversion rights and take back ownership and control of DataCo. *Cf. id.* at 6-7 (the necessity of

[10] Under the MFJ, Judge Greene approved conditional interests where (i) the amount of the investment was relatively minor compared to the BOC's overall revenues, (ii) there was a genuine contingency to the exercise of the conditional interest, and (iii) the conditional interest did not give the BOC an incentive to disadvantage the target company's competitors. *United States v. Western*

"regulatory and judicial approvals" held sufficient to establish "that the occurrence of contingencies permitting NYNEX to enhance its interest in Tel-Optik is genuinely in question."). Finally, as we explain below in part III, the conversion rights at issue here will not give Bell Atlantic/GTE the incentive to discriminate against DataCo's competitors. Moreover, the existence of the thorough 271 approval process and the availability of complaint procedures before the Commission are, *in and of themselves*, sufficient to satisfy the third factor of Judge Greene's test. *Cf. id.* at 7 (existence of MFJ waiver review process alleviated risk of discrimination from conditional interest because any attempt to discriminate "would almost certainly be made known to the Court during any subsequent waiver proceedings").

II. PENDING INTERLATA RELIEF, BELL ATLANTIC/GTE WILL NOT CONTROL DATACO.

As explained fully in our Supplemental Filing, DataCo's corporate governance structure will ensure that Bell Atlantic/GTE has no ability to exercise control over DataCo. Under settled Commission precedent and fundamental principles of corporate law, control (either *de jure* or *de facto*) lies with the entity responsible for conducting day-to-day management of corporate affairs, receiving revenues and meeting financial obligations, and managing use of the corporation's facilities. Here, there is no question that DataCo's independent board of directors and management team – tethered to DataCo's public shareholders by fiduciary duties of care and loyalty – will have sole charge over these responsibilities. *See* Supp. Filing at 44-49.

Elec. Co., No. 82-0192, at 5, 6-7 (D.D.C. Aug. 7, 1986) ("Conditional Interest Order").

A. The Proposed Investor Safeguards Are Commonplace Protections Routinely Approved By the Commission.

AT&T, CompTel and NextLink take aim at our proposed investor safeguards and argue that these safeguards will somehow enable Bell Atlantic/GTE to exercise day-to-day control over DataCo. The day-to-day business of DataCo will be managed by its officers under the direction of its independent board of directors. The proposed safeguards are run-of-the-mill prophylactic measures designed only to protect Bell Atlantic/GTE's present and future interests in DataCo, and not to give it any say over DataCo's ordinary business decisions. In an effort to characterize the measures as unusual, AT&T and CompTel distort the extent of control these safeguards provide, ignore the significant limitations on Bell Atlantic/GTE's ability to control DataCo, and directly contradict more than 30 years of Commission precedent. Indeed, AT&T does not even believe its own assertions, as demonstrated by numerous submissions to the Commission defending its proposed acquisition of MediaOne.

AT&T claims that "[m]any of the provisions" detailed in the Supplemental Filing are not appropriate minority investor safeguards. But it specifically identifies only *one* – that Bell Atlantic/GTE's consent is required for "agreements or arrangements" that "materially adversely affect DataCo's results of operation or financial condition."[11] AT&T suggests that this provision will

[11] AT&T Opp. at 23 (quoting Supp. Filing, Schedule A). For its part, CompTel baldly asserts that "*many* investor protections . . . provide [Bell Atlantic/GTE] with great control . . . over day-to-day operations." CompTel at 6. Nevertheless, CompTel fails to identify a single offending provision. Instead, it argues that Bell Atlantic/GTE's control over fundamental corporate changes – such as a change in the nature of DataCo's business or DataCo's liquidation – are improper exercises of control. This claim is flatly contradicted by settled Commission precedent. *See In re Puerto Rico Telephone Authority*, 14 FCC Rcd 3122, ¶ 44 (1999). In light of CompTel's failure to identify a single investor safeguard that intrudes on the day-to-day operation of DataCo, its citation to *In re Application of Baker Creek Communications*, 13 FCC Rcd 18709 (1998), is far afield. In *Baker*

somehow give Bell Atlantic/GTE "the right to review all significant agreements contemplated by DataCo," AT&T Opp. at 23, but that interpretation is absurdly overbroad. The full text of the provision states that Bell Atlantic/GTE's consent will be required for agreements that "contain provisions that materially adversely affect DataCo's results of operation or financial condition, result in a default, or require a material payment as a result of a termination or default upon or after Newco's exercise of its conversion right." Supp. Filing, Schedule A. Taken as a whole, it is clear that this provision will only apply to extraordinary agreements that threaten DataCo's long-term viability, not to agreements made in the ordinary course of business.

Numerous Commission precedents hold that such a provision will not give Bell Atlantic/GTE control over DataCo. For example, in *In re Puerto Rico Telephone Authority*, 14 FCC Rcd 3122 (1999), the Commission found that safeguards "designed to ensure that" a company "does not depart from its own ordinary business practices without first obtaining the consent of the buyer" qualify as "ordinary and reasonable investor protections." *Id.* ¶ 43. Specifically, the Commission held that safeguards placing limitations on a company's ability to enter "into new lines of business" or to make "substantial and material alterations to current contracts or agreements" did not give an investor control over that company. *Id.* ¶ 44. Similarly, in *In re Applications of Roy M. Speer*, 11 FCC Rcd

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Creek, the Commission concluded, in the partnership context, that a limited partner's ability to review and approve the company's business plan was not "one of the typically permissible investment protections." *Id.* ¶ 29. Here, Bell Atlantic/GTE will not have the right to oversee the implementation of DataCo's business plan, and none of the investor safeguards can be reasonably read to grant (or even imply) this power.

14147 (1996), the Commission held that an investor having veto power over "any transaction not in the ordinary course of business" did not control the company in which it had an investment. *Id.* ¶ 18. Thus, AT&T is wrong to assert that Bell Atlantic/GTE will exercise *day-to-day* control over DataCo by virtue of its right to veto "agreements or arrangements" concerning DataCo's long-term financial viability – those agreements or arrangements are by definition *not* made on a day-to-day basis.

More generally, over 30 years of Commission precedents confirm that all of the various investor safeguards we propose, taken together, do not constitute control.[12] AT&T offers only a glib assertion that in each decision in this unwavering line of cases, "the Commission found that the minority shareholder's ability to exert control was mitigated . . . by an identifiable and independent person or group of persons that would also invest in and manage the entity." AT&T Opp. at 24. Contrary to AT&T's suggestion, the same is true here. Nine out of the ten members of DataCo's board of directors will be completely independent of, and have no relationship with or ties to, Bell Atlantic or GTE. This independent board will represent public shareholders owning 90% of DataCo's voting equity, will owe fiduciary duties of care and loyalty to those shareholders, and will be subject to removal or legal action by the shareholders if they fail to fulfill these duties. The board will also direct an experienced management team, many of whom will have worked for DataCo when it was still known as BBN (*i.e.*, before it was even acquired in the first place by GTE). There will be no

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[12] *See, e.g.*, *Puerto Rico Telephone Authority*, *supra*, ¶ 43; *In re Application of National Broadcasting Co.*, 6 FCC Rcd 4882, ¶ 4 n.2 (1991); *In re McCaw Cellular Communications, Inc.*, 4 FCC Rcd 3784, ¶ 40 (1989); *In re Data Transmission Co.*, 44 F.C.C.2d 935 (1974); *In re Flathead Valley Broadcasters*, 5 Rad. Reg. 2d 74 (Rev. Bd. 1965).

common officers or employees between DataCo and Bell Atlantic/GTE. Nothing more is required under Commission precedent to insulate a firm's management from control by an investor.[13]

Moreover, even in cases where the management and voting shareholders are weak in relation to the minority investor, the Commission has adhered to its rule that investor safeguards do not confer control. For example, in *In re News International*, 97 F.C.C.2d 349 (1984), Warner Communications, a cable provider "own[ing] numerous cable television systems throughout the United States," made an investment in Chris-Craft, a firm owning only "one UHF and five VHF television stations." *Id.* ¶¶ 3-4. Despite the fact that Warner's investment: (i) included the purchase of preferred shares carrying a 20% voting interest in the broadcaster; (ii) came with an option to convert those preferred shares into 42.5% of the broadcaster's voting common stock; and (iii) carried with it significant investor protections, including the right to veto mergers, acquisitions, or substantial dispositions of assets, the Commission concluded that Warner did not control Chris-Craft. *Id.* ¶¶ 18-21. Notwithstanding Chris-Craft's insignificant size and experience relative to Warner's, the

[13] Thus, in *In re Quincy D. Jones*, 11 FCC Rcd 2481 (1995), the Commission concluded that an investor holding non-voting shares did not control the broadcaster in which it had invested, despite the right to vote on matters ranging from "the sale or other disposition of any material portion" of station assets to "any acquisition or any agreement to acquire any entity." *Id.* ¶ 9. The Commission based its decision, in part, on the recognition that the broadcaster's management team had "extensive broadcasting, television programming and other business and management experience." *Id.* ¶ 24. Likewise, DataCo's board and management team will be composed of individuals with extensive experience at the helm of a leading Internet company.

Commission, relying on agency precedents dating back to 1964, found that the investor safeguards did not allow Warner to regulate station "finances, personnel policy and actions, or programming, which are the three most important factors for determining control." *Id.* ¶ 20.

Thus, even if it were the case that Bell Atlantic/GTE is one of DataCo's largest individual shareholders, Commission precedent still confirms that its investor safeguards do not give the combined company control over DataCo.[14] Safeguards that protect investments from extraordinary

[14] AT&T's claim that the proposed anti-takeover provision, which limits to 10% the amount of Class A shares that can be voted by a single public shareholder or group of related shareholders, is actually a scheme to seize *de facto* control of DataCo is without any merit. The voting limitation is merely designed to ensure that DataCo remains a widely held, publicly owned company until the option is exercised. *See* Gilson Declaration ¶ 9. It is also a reasonable safeguard to prevent competitors in the Internet backbone market – such as AT&T – from acquiring a controlling stake in DataCo that could allow them to take actions that would compromise the value of Bell Atlantic/GTE's option. In short, it is designed to protect the independence of DataCo, not to enable Bell Atlantic/GTE to usurp that independence. In addition, the 10% limitation will not prevent up to nine other shareholders from acquiring a voting stake equal to Bell Atlantic/GTE's, and these other shareholders could still outvote Bell Atlantic/GTE by a ratio of nine to one. AT&T cites 47 CFR § 1.2110(b)(4)(iv)(B), which establishes affiliation rules for designated minority-owned businesses to promote racial and gender diversity in broadcasting. The affiliation regulations in the ownership-

events or that “provide a workable outline for corporate management and structure,” are not indicative of control so long as they do not “set policy for the day-to-day operation” of the company. *In re News International*, 97 F.C.C. 2d 349, ¶ 20 (1984).

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diversity context have nothing to do with the question of day-to-day control; they are designed to prevent the abuse of racial and gender preferences.

Indeed, AT&T's arguments here are point-blank refuted by its own assertions in the MediaOne merger docket. By acquiring MediaOne, AT&T will inherit a 25.51% interest in Time Warner Entertainment ("TWE"). If TWE's 12.6 million cable subscribers are added to AT&T's post-merger total, AT&T will be in violation of the Commission's 30% horizontal cable ownership cap. And if AT&T seriously believed the arguments it is making *here*, it would be in serious jeopardy *there*. Once it acquires MediaOne, AT&T will inherit the right to vote on a wide range of TWE "Participant Matters" that go beyond the DataCo investor safeguards listed in Schedule A of our Supplemental Filing. AT&T's Participant Matters will include: (1) the merger of TWE, (2) the sale or transfer of assets constituting more than 10% of TWE's assets; (3) expansion of TWE into new lines of business; (4) specified issuances of additional partnership interests; (5) incurrence of debt or money borrowed above a defined ratio; (6) acquisitions costing more than $750 million or 10% of TWE's consolidated revenues for its most recent fiscal year; (7) cash distributions above a specified level; (8) dissolution or voluntary bankruptcy of TWE; (9) transfer or sale of certain major interests in TWE or any sub-partnership thereof; (10) admission of a new general partner; and (11) indemnification of any partner or affiliate for liability in excess of $500 million.[15]

[15] *See In re Transfer of MediaOne to AT&T*, Ex Parte Comments of AT&T and MediaOne, CC Docket No. 99-251, at 2-3 n.7 (Nov. 24, 1999) (hereafter "Ex Parte Comments").

Notwithstanding its unquestioned right to vote on virtually all of the same corporate actions at issue here (and more), AT&T has asserted in the MediaOne docket that it will *not have control* over TWE because it "will have no role in the day-to-day management and operation of TWE's business," and that its interest in TWE is "insulated and therefore not attributable" under the "cable attribution rules."[16] In support of this position, AT&T has explained that "the Commission routinely permits insulated limited partners, LLC members, and other entities to participate in matters of this type as a means of protecting their investment without triggering attribution."[17] Moreover, AT&T has argued that the "Commission has viewed these rights as necessary to protect the investor's interest, not to involve the investor in the management of the entity or to give it control or influence."[18] AT&T's own corporate law expert, Professor John C. Coffee, Jr., declared that AT&T will not control TWE because "none" of the transactions covered by AT&T's Participant Rights "relate[s] to ordinary business transactions or the normal business operations of TWE."[19]

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[16] *Id.* at 8.

[17] *See In re Transfer of MediaOne to AT&T*, Ex Parte Reply Comments of AT&T and MediaOne, CC Docket No. 99-251, at 6 n.3 (Dec. 21, 1999) (hereafter "Ex Parte Reply Comments").

[18] Ex Parte Comments at 12. *See* Ex Parte Reply Comments at 12 ("Participant Rights do not involve AT&T in the management of TWE or give it control or influence over TWE."); *id.* "the Commission allows investors to retain such rights without triggering attribution"); *id.* (rights to vote on Participant Matters "are squarely within the types of extraordinary investor protection rights that do not preclude insulation"); Ex Parte Comments at 9 ("These matters are all the types of shareholder protection rights the Commission has routinely allowed investors to have without triggering attribution."); *id.* at 13 (rights to vote on Participant Matters give AT&T "no role in the day-to-day management or operation of TWE").

[19] *In re Transfer of MediaOne to AT&T*, Declaration of Professor John R. Coffee, Jr., Attached as Appendix E to the Reply Comments of AT&T and MediaOne, CC Docket No. 99-251, at 8 (Sept. 17, 1999). *See also id.* at 11 ("[v]iewed either in terms of standard business practice or the legal definition of control under Delaware law or the law of the vast majority of states, AT&T and MediaOne simply do not have the power to control decisions, policies, or practices at TWE.").

In addition, the investor safeguards designed to protect Bell Atlantic/GTE's prospective future interest in DataCo are analogous to post-execution, pre-closing safeguards typical of most corporate acquisitions. *See* Gilson Declaration ¶ 26. Here again, AT&T has employed nearly all of the investor safeguards proposed for Bell Atlantic/GTE (and then some) in its proposed acquisition of MediaOne. *See id.* In light of these shameless self-contradictions, the Commission should treat all of AT&T's arguments with a healthy dose of suspicion. AT&T's hypocrisy demonstrates an extraordinary disrespect for the Commission, and it reflects a deliberate effort to use the regulatory process as a sword against its competitors and against the public interest.

B. The Right to Elect One Member to DataCo's 10-Member Independent Board Will Not Give Bell Atlantic/GTE Control.

Continuing its pattern of hyperbole, AT&T claims that as a result of its right (as the Class B shareholder) to elect one of ten board members, Bell Atlantic/GTE "may very well control the entire board of directors of DataCo." AT&T Opp. at 26. This argument is absurd on its face, wrong as a matter of settled corporate law, and contrary to Commission precedent. The corporate governance structure described in the Supplemental Filing is specifically designed to limit the influence Bell Atlantic/GTE has over DataCo's board of directors.[20] The board will consist of a nine-to-one majority of directors who will have no affiliation with Bell Atlantic or GTE.[21] All of the directors will be bound by firmly established legal duties of good faith and loyalty to DataCo's public shareholders. AT&T's premonition that the lone Class B director will be able to exert influence in excess of his or

[20] AT&T's general claim of control is also belied by the fact that under the proposed corporate governance structure, Bell Atlantic/GTE and DataCo will have *no* common officers or employees.

[21] One director (who is ineligible to serve as chairman of the board) will be appointed by Bell Atlantic/GTE as the Class B shareholder. Eight of the remaining nine directors will have no past or present affiliation with Bell Atlantic or GTE. Supp. Filing at 31-32. The final director will be the CEO of DataCo and will have no continuing affiliation with GTE or Bell Atlantic. Five of the unaffiliated board positions will be up for election by the public shareholders six months after the IPO, and the remaining positions will be up for election within one year of the IPO. The slate of directors to be voted on by the public shareholders will be nominated by the independent board of DataCo.

her solitary vote is unfounded. *No action taken by the DataCo board of directors will require a unanimous vote.* Moreover, the Commission has concluded in several cases that parties with far more significant board representation than Bell Atlantic/GTE will have did not enjoy control sufficient to warrant attribution or to suggest a transfer of control.[22]

[22] *See, e.g., News International*, 97 F.C.C.2d 349, ¶¶ 5, 17 (concluding that the acquisition of a 20% stake of voting preferred stock did not constitute a "transfer of control," because the 80% stakeholder "will retain majority control in terms of voting power and of electing a majority of the Board of Directors").

In addition, the independence of DataCo is confirmed by settled corporate law precedent holding that "the presence of a *majority* of outside independent directors will materially enhance" a finding that a board has properly exercised its fiduciary duties of care and loyalty to public shareholders.[23] By any standard, the proposed ten-member DataCo board is no elevation of form over substance, but rather is designed to offer the type of insulation from day-to-day activities (while providing for minority investor oversight of major corporate transactions) that is required by Commission precedent. The modern corporate governance movement has extinguished any basis for AT&T's exaggerated concern that DataCo's board might secretly be in Bell Atlantic/GTE's pocket. Not only has nearly every corporation in America increased the use of independent directors, but the entire operation of corporate boards has become more informed, more transparent, and more accountable as a result of a series of influential Delaware cases.[24] This legal accountability (coupled with significant shareholder accountability) has led to a new degree of independence among directors, an increase in the thoroughness of the board decision-making process, and the frequency and length of board meetings. Moreover, the influential case of *Kahn v. Tremont Corp.*, No. 12339, 1994 WL 162613 (Del. Ch. Apr. 22, 1994), has set high standards for establishing and measuring the true independence of board members. In *Kahn*, three supposed independent board members were found to be interested (and thus disqualified from passing on a certain transaction) because they had minimal and even remote contacts with the controlling shareholder. Thus, under settled law, the threshold

[23] *Unitrin, Inc. v. American Gen. Corp.*, 651 A.2d 1361, 1375 (Del. 1995) (*citing Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (emphasis added)). *See also Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140, 1154 (Del. 1990).

[24] *See, e.g., Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985).

for director "independence" is sufficiently high to alleviate any concerns about a board that will allow Bell Atlantic/GTE to exercise behind-the-scenes, *de facto* control over DataCo.[25]

[25] AT&T's assertion that Paul Gudonis, DataCo's prospective CEO (or any other executive of DataCo) will remain beholden to GTE or Bell Atlantic because of a past affiliation (in Mr. Gudonis's case, as head of GTE-I) is without merit. DataCo executives, regardless of past affiliation, must act consistent with the fiduciary duties of care and loyalty they owe DataCo's public shareholders. Any decisions by DataCo executives that are contrary to the interests of DataCo would likely constitute a breach of the duty of care, and, if the decision inures to the personal financial benefit of the executive (for example, if the executive forgoes an opportunity for DataCo in order to secure the good favor of Bell Atlantic/GTE as his potential future employer), it may well also violate the duty of loyalty. Moreover, if past affiliation of executives were enough to establish control, then by that reasoning, AT&T would have control over Qwest (whose CEO, Joe Nacchio, came from AT&T), and Teligent (whose CEO, Alex Mandl, also came out of AT&T). Similarly, Hughes Electronics would have control over AT&T (because AT&T Chairman Mike Armstrong was formerly chairman of Hughes) and Vodafone AirTouch would have control over AT&T Wireless (because AT&T Wireless executive Mohan Gyani was a board member of Vodafone AirTouch). Significantly, several of these examples of past affiliation are coupled with a significant minority ownership interest: AT&T owns approximately 40% of Teligent through Liberty Media, and will own an equity interest in Vodafone AirTouch through its pending acquisition of MediaOne.

Moreover, AT&T's claims are again put to the lie by its own arguments to the Commission in the MediaOne docket. Following its merger with MediaOne, AT&T will "have the right to appoint two of six TWE Board Members."[26] Yet, AT&T claims there that it will not exercise control over TWE. Likewise, AT&T made the same claim with respect to its ownership of Liberty Media, a video programmer that is AT&T's wholly owned subsidiary but has its own "separate public shareholders" through a tracking stock.[27] AT&T has argued to the Commission that it does not control Liberty because Liberty has complete "operational autonomy,"[28] *despite the fact that AT&T has the right to select one-third of Liberty's directors*. The basis for AT&T's position: "Liberty is, in effect, a structurally separate company from AT&T" because a majority of "the Liberty Board is and will be controlled by persons" other than AT&T.[29]

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[26] *In re Transfer of MediaOne to AT&T*, Applications and Public Interest Statement, CC Docket No. 99-251, at 17 n.44 (July 7, 1999).

[27] *Id.* at 10.

[28] *In re Transfer of MediaOne to AT&T*, Ex Parte Reply Comments of AT&T and MediaOne, CC Docket No. 99-251, at 14-15 (Dec. 21, 1999).

[29] *Id.* at 9.

C. The Reasonable Commercial Contracts Between the Companies Will Not Give Bell Atlantic/GTE Control Over DataCo.

AT&T, CompTel and NextLink argue that the DataCo solution is untenable because the various commercial contracts between DataCo and Bell Atlantic/GTE will constitute impermissible involvement by Bell Atlantic/GTE in the day-to-day activities of DataCo.[30] But these contracts will do just the opposite; they will ensure that DataCo remains strong and viable, and they will smooth its transition to a stand-alone entity.

NextLink objects to the idea of a marketing contract between DataCo and Bell Atlantic/GTE and compares the proposed contract to the marketing arrangement held to violate section 271 in the Commission's *Qwest Order*. NextLink Comments at 11-12 (citing *AT&T v. Ameritech & Qwest Communications Corp.*, 13 FCC Rcd 21438 (1998)). But that objection is completely off point. In the *Qwest Order,* the Commission denied a proposed joint marketing arrangement between U S WEST and Qwest Communications in which Qwest's interLATA service would be marketed by U S WEST in in-region states where U S WEST had not yet received 271 relief. *See AT&T v. Ameritech and Qwest Communications Corp.*, 13 FCC Rcd 21438, ¶ 39 (1998). The Commission concluded that through the marketing plan, "defendants are providing in-region, interLATA services . . . when the defendants have not adequately opened their local markets." *Id.* By contrast, here, the marketing arrangement proposed in Schedule B of our Supplemental Filing will comply in all respects with the *Qwest Order* and will be strictly limited to those locations where Bell Atlantic is permitted to market interLATA services by section 271 – that is, outside the Bell Atlantic region and within those in-region states, like New York, where Bell Atlantic has received 271 authority.

[30] *See* AT&T Opp. at 27; CompTel at 7-8; NextLink Comments at 11-12.

More generally, each of the transitional services arrangements and other contracts listed in Schedule B will be commercially reasonable and structured in a way that eliminates any potential for the exercise of *de facto* control over DataCo. For example, each contract for the provision of transitional administrative support services will be limited to a reasonable period, such as one year, will be terminable upon reasonable notice by DataCo, and will only be renewable by DataCo *at its option*. DataCo's board and management, not Bell Atlantic/GTE, will decide in each instance whether it is less costly and more efficient to contract with Bell Atlantic/GTE for the service in question or whether it will maximize shareholder value to perform the service internally or to contract with another outside source. It is not an empty promise when we say that each contract will be commercially reasonable: The management and board of DataCo will be bound to act in the best interests of their public shareholders, and significant legal and professional incentives will guarantee fulfillment of these fiduciary duties.

In addition, GTE currently offers many of these same services to unaffiliated third parties. In none of those cases does GTE dominate the day-to-day operations of those third-party companies. These various arm's-length dealings with third parties demonstrate the reasonableness of the contractual arrangements we propose and also provide a set of market-based controls for the terms of comparable contracts with DataCo.

* * *

In the end, the issue of whether Bell Atlantic/GTE will "control" DataCo turns not on a mechanistic formula, but on whether Bell Atlantic/GTE will exercise *de facto* control over DataCo

– that is, whether it will "dominate the management of [DataCo's] corporate affairs."[31] Applying the Commission's standard analysis, Bell Atlantic/GTE will not have *de facto* control over DataCo. *De facto* control is not possible under the corporate governance structure proposed here because of the assurances of an *independent* board and management team for DataCo. Moreover, the other relevant factors in *de facto* control analysis – control over financing, facilities, and personnel ("the three most important factors in determining control")[32] – decisively establish DataCo's independence.

AT&T's response on these factors – tellingly relegated to a footnote – is conclusory and amounts to nothing more than an assault on Commission precedent. *See* AT&T Opp. at 22 n.23. In fact, AT&T offers no argument as to how the investor safeguards or Newco's 10% minority interest will result in Newco's "dominating" the essential day-to-day operations of DataCo. Any such suggestion is belied by the rigorous independent corporate structure of the proposed DataCo spinoff.

III. THE DATACO PROPOSAL IS FULLY CONSISTENT WITH THE POLICIES UNDERLYING SECTION 271.

[31] *Trinity Broadcasting of Florida, Inc.*, 15 Comm. Reg. (P & F) 757 (1999).

[32] *Intermountain Microwave*, 24 Rad. Reg. (P & F) 983, 984 (1963); *see also In re News International, PLC*, 97 F.C.C.2d 349, ¶ 20 (1984).

As our opponents argue, a basic premise underlying section 271 is that BOCs will have an incentive to open their markets to local competition more quickly if doing so opens the door to participation in new and lucrative lines of business. As stated by ALTS, section 271 was intended to be "a positive inducement for the BOCs to cooperate with market-opening measures."[33] Assuming as much, the question the Commission faces is whether a combined Bell Atlantic/GTE will have a greater incentive to comply with section 271, and thus to open its local markets to competition, if it has a right to take DataCo back once it secures the requisite interLATA relief.

The answer is plainly yes. DataCo holds a unique market position as the *only* non-IXC-affiliated top-tier Internet backbone provider. If Bell Atlantic/GTE fails to gain the requisite 271 approvals within the five-year period, it would lose its rights to own this uniquely valuable business. Beyond this, GTE-I is also uniquely valuable to Bell Atlantic/GTE because of the investment GTE has made in developing and expanding GTE-I's business, and because of the specific vertical synergies that only GTE-I will bring to the merger of Bell Atlantic and GTE. Thus, Bell Atlantic/GTE has an overwhelming incentive to obtain sufficient interLATA relief to exercise its conversion rights.

Without an option to take back DataCo, Bell Atlantic/GTE would have to build out its own national Internet backbone or negotiate and secure regulatory approvals for a major acquisition of another backbone provider (albeit one that is not among the top tier on the Internet). While this process would significantly delay Bell Atlantic/GTE's participation in the Internet backbone market, the present DataCo proposal will allow Bell Atlantic/GTE to participate in the backbone market

[33] Comments of the Association for Local Telecommunications Services at 3 (Feb. 15, 2000).

promptly after complying with section 271. Indeed, after exercising its option, Bell Atlantic/GTE will immediately be able to offer bundled voice and Internet services nationwide, which will benefit consumers and serve the public interest by bolstering DataCo's position in the concentrated Internet backbone market. The "carrot" that these valuable benefits represent will spur Bell Atlantic/GTE to comply more rapidly with section 271's market-opening conditions. Moreover, the DataCo proposal adds a powerful additional "stick" to section 271 that will spur Bell Atlantic/GTE to open its local markets more quickly: Bell Atlantic/GTE will lose its right to take DataCo back if the Commission does not grant the required section 271 approvals within five years.

Nevertheless, AT&T claims that the DataCo proposal would "violate the purposes of Section 271." AT&T Opp. at 28. AT&T asserts that "the transaction gives Bell Atlantic obvious incentives to discriminate in favor of DataCo" by exploiting "its dominant status and control of bottleneck facilities." *Id.* at 28-29. Nothing could be further from the truth. GTE-I does not – and DataCo will not – rely to any significant degree on Bell Atlantic's core LEC facilities to provide Internet and data services. Indeed, in the markets AT&T identifies as profitable targets for discrimination – "urban, high-density, business-rich customer bases in Bell Atlantic cities," *id.* at 28 – the point-to-point circuits DataCo needs are available from multiple providers on a competitive basis. Any possible gain Bell Atlantic/GTE could receive from discriminating in DataCo's favor is greatly outweighed by the risk that such discrimination would bring with it the denial of needed 271 approvals and the draconian penalty of barring Bell Atlantic/GTE from lucrative long distance and Internet backbone markets.

On balance, the DataCo proposal therefore gives Bell Atlantic/GTE an overwhelming incentive *not* to discriminate.[34]

Likewise, AT&T is wrong to assert that Bell Atlantic/GTE, as part of its DSL offering, will discriminate against ISPs that resell Bell Atlantic's DSL service but do not rely on DataCo for Internet backbone transport. As shown in the attached Declaration of Raymond F. Albers (appended hereto at tab B), any such discrimination would be easily detected and would only drive customers from DSL to cable modems – a result Bell Atlantic/GTE cannot countenance, given DSL's already precarious position in the broadband market.[35]

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[34] AT&T argues that Bell Atlantic/GTE could profit from discrimination by transferring the option to another purchaser. *See* AT&T Opp. at 29. In fact, by transferring its conversion rights, Bell Atlantic/GTE would forfeit: (i) all of the synergies associated with the ability to provide customers a full bundle of services nationwide, and (ii) the unique value represented by GTE-I's status as a first-tier Internet backbone business. These losses would deal a body-blow to Bell Atlantic/GTE's ability to keep pace with vertically integrated competitors like AT&T.

[35] It is highly ironic that AT&T, which dominates broadband Internet access and discriminates with an iron fist against competing ISPs, should complain about hypothetical discrimination on the open-access DSL platform.

Finally, AT&T argues that rejecting the DataCo proposal "will create the strongest incentives for section 271 compliance" because "Bell Atlantic will be even more motivated to open its local market if it has to do so before it would be permitted to simultaneously merge and obtain ownership and control of GTE's interLATA Internet business." AT&T Opp. at 31.[36] This assertion is nothing more than a tag-line rehash of AT&T's ownership and control arguments addressed above. Bell Atlantic/GTE will own only a 10% equity interest in DataCo, as expressly authorized by the Act, and DataCo will be under the control of an independent board of directors that owes fiduciary duties of care and loyalty to public shareholders. For its part, Bell Atlantic/GTE will have an enhanced incentive to open its local markets rapidly and secure the section 271 approvals needed to permit the exercise of its conversion rights. The DataCo proposal therefore significantly furthers the Act's purpose of promoting competition in all telecommunications markets.

[36] By contrast, CompTel urges the Commission to "require the merged entity to exercise its conversion rights within two years from the close of the merger." CompTel at 10. While this proposal is grossly unreasonable, given that Bell Atlantic had to invest four years of unbroken effort and billions of dollars in new systems and testing to satisfy the checklist requirements and gain 271 approval in just one state, New York, it is nevertheless premised on the recognition that a reasonable time limit "would further the goals of the Communications Act by forcing the merged entity to accelerate its efforts to open its local markets in compliance with Sections 251 and 271." *Id.*

CONCLUSION

For the foregoing reasons, Bell Atlantic and GTE respectfully request that the Commission promptly grant the license transfer applications required to complete their merger.

Respectfully submitted,

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Mark J. Mathis
John Thorne
Michael E. Glover
Leslie A. Vial
Lawrence W. Katz
BELL ATLANTIC CORPORATION
1095 Avenue of the Americas
New York, New York 10036

Richard E. Wiley
R. Michael Senkowski
Suzanne Yelen
WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, D.C. 20006

____
William P. Barr
GTE CORPORATION
1850 M Street, N.W.
Suite 1200
Washington, D.C. 20036

Steven G. Bradbury
John P. Frantz
Kelion N. Kasler
M. Todd Henderson
KIRKLAND & ELLIS
655 Fifteenth Street, N.W.
Suite 1200
Washington, D.C. 20005

Counsel for Applicants Bell Atlantic Corporation and GTE Corporation

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